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No. 83-297

IN THE

Supreme Court of the United States

OCTOBER TERM, 1983

ARMCO INC.,

Appellant,

v.

DAVID C. HARDESTY, JR.,
State Tax Commissioner of West Virginia,

Appellee.

ON APPEAL FROM THE SUPREME COURT OF APPEALS OF WEST VIRGINIA

APPELLANT'S REPLY BRIEF

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INTRODUCTION

The Brief on the Merits filed by the Appellee, and the Brief of the State of Washington as *amicus curiae* in support of Appellee, assert two points toward which these remarks are directed. The first is that the solicitation within West Virginia of some of the sales at issue here by Armco's nonresident salesmen provides the nexus required by the Due Process Clause and the Commerce Clause to impose the taxes involved here. And the second is that the existence of another tax imposed at a higher rate upon local manufacturers in West Virginia cures the otherwise discriminatory nature of the West Virginia tax on wholesale sales. The question of the application of the unitary business theory to the facts presented by this

appeal has been fully discussed in the briefs previously filed. It will not be discussed further here, except to note that the *amicus* Washington State supports Armco's view that application of the unitary business theory in this case is inappropriate.

Aside from two potentially confusing points, there remains no significant disagreement as to the facts. The first point relates to whether Armco serviced products in West Virginia. The record clearly establishes that Armco did not service, install or repair any products which it sold to customers in West Virginia. J.A. 21, 28. Appellee makes reference to the statement of a witness regarding "service work" performed by Armco in West Virginia. Appellee's Br. 4-5; *see* J.A. 17. A reading of the entire record makes it clear that the witness was referring to "service" of the customer account, not the product sold. And second, Appellee makes a series of conclusory statements regarding the degree to which solicitation in West Virginia contributed to sales by Armco to West Virginia customers. Appellee's Br. 15, 49-50, 64-65. Armco notes that there is no evidence in the record to support any of those statements.

ARGUMENT

I

TERRITORIAL LIMITATIONS ON STATE TAXING POWER

With regard to the constitutional significance of the solicitation within West Virginia by nonresident Armco salesmen of some of the sales in question here, the proceedings below in West Virginia deserve mention. At the administrative hearing level, the West Virginia State Tax Commissioner, an officer of the executive rather than judicial branch of the state government, had no authority to pass upon the constitutional validity of a West Virginia tax. *State ex rel. Karnes v. Dadisman*, 153 W. Va. 771, 781; 172 S.E.2d 561, 568 (1970). The Circuit Court in West Virginia, however, squarely faced the constitutional issue and held that "the solicitation on a part-time basis in this state by the nonresident traveling salesmen does not constitute a 'substantial nexus'." J.S. 27a. Interestingly, on appeal to the

Court below, it declined to consider the question of the constitutional impact of solicitation within the state. It turned instead to the unitary business theory, even though it had previously held mere solicitation sufficient for purposes of finding the constitutionally required nexus. *Cincinnati Milacron Co. v. Hardesty*, 290 S.E.2d 902 (1982).[1]

While the opinion below is silent with respect to the constitutional aspects of solicitation within West Virginia, it is difficult not to conclude that reliance by the Court below on the unitary business theory was attributable to the findings by the Circuit Court that sales of metal buildings by Armco in West Virginia involved no solicitation at all within the state, and that, of the remaining sales at issue, some 77 percent were solicited outside West Virginia. J.S. 26a, 30a. The Court below does not mention these findings. Nor for that matter does the Appellee in urging this Court to conclude that the activities of Armco's salesmen were sufficient to warrant taxation of the gross receipts from all of Armco's sales to customers in West Virginia. But in any event, the curious result of all this is that the State of West Virginia now seeks affirmance in this Court on a theory flatly rejected by the lower court in West Virginia and at a minimum not deemed worthy of mention by the Court below.

A. THE *NORTON* DISSOCIATION RULE CONTINUES TO PROHIBIT THE GROSS RECEIPTS TAXES IMPOSED UPON ARMCO BY WEST VIRGINIA.

1. THE DEMISE OF *SPECTOR* DID NOT ELIMINATE OR WEAKEN THE *NORTON* RULE.

In *Spector Motor Service, Inc. v. O'Connor*, 340 U.S. 602 (1951), the taxpayer was engaged in the interstate transportation of freight. As part of its interstate business it leased two terminals in Connecticut at which it employed some 27 people

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1 In fact, in a case argued before and decided by the Court below on the same days as this case, the Court below followed *Cincinnati Milacron* in concluding that mere solicitation was sufficient to provide the required nexus. *Williams and Co. v. Dailey*, 303 S.E.2d 737 (1983).

in various capacities. Connecticut sought to impose an apportioned net income tax upon the taxpayer "for the privilege of carrying on exclusively interstate transportation in the State." 340 U.S. at 608. This Court held unconstitutional the tax on the "privilege" of engaging in interstate commerce without regard to "how fairly it is apportioned to business done within the state." 340 U.S. at 609.

Some 26 years after the *Spector* decision, this Court was faced with a taxpayer engaged in interstate commerce, but conducting all of its business activities within the State of Mississippi. *Complete Auto Transit, Inc. v. Brady*, 430 U.S. 274 (1977). It transported motor vehicles from a railhead in Jackson, Mississippi to various dealers within the state, and the claim was made that under the *Spector* rule Mississippi could not impose a net income tax on the taxpayer. Quite understandably, that was the end of the *Spector* theory of immunity. It was overruled by *Complete Auto* which held that interstate commerce must pay its own way in terms of fairly apportioned state net income taxes. At the same time, however, *Complete Auto* was careful to point out that a state tax can only be "applied to an activity with a substantial nexus with the taxing State." 430 U.S. at 279.

Neither *Spector* nor *Complete Auto* involved a question of nexus or extra-territorial taxation because the net income taxes involved there were applied to net income earned within the taxing jurisdictions. In the present case, on the other hand, the issue is one of nexus. Armco maintains that the sales in question here were dissociated from its local activities within West Virginia and cannot be constitutionally taxed under the rule of *Norton Co. v. Dep't of Revenue of Illinois*, 340 U.S. 534 (1951). Appellee, however, links *Norton* and *Spector*, which were decided during the same Term of this Court, and portrays Armco as conducting a substantial business in West Virginia while hiding behind the Constitution to avoid its fair share of state taxes. That portrayal is more emotional than accurate or helpful. Armco makes no claim to immunity from tax based upon the interstate character of its sales. Its claim is simply that West Virginia here is attempting to reach the

proceeds from transactions lacking substantial nexus with the state and so is attempting to "tax value earned outside its borders." *ASARCO Inc. v. Idaho State Tax Comm'r*, 458 U.S. 307, 315 (1982).

The teaching of *Norton* has nothing to do with the *Spector* issue of the extent to which interstate commerce may be subjected to state taxation. To the contrary, the problem addressed by *Norton* is the extent to which a state may reach outside its borders to tax transactions, interstate or otherwise. The *Norton* Court said:

> Where a corporation chooses to stay at home in all respects except to send abroad advertising or drummers to solicit orders which are sent directly to the home office for acceptance, filling, and delivery back to the buyer, it is obvious that the State of the buyer has no local grip on the seller. Unless some local incident occurs sufficient to bring the transaction within its taxing power, the vendor is not taxable. *McLeod v. Dilworth Co.*, 322 U.S. 327.
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> * * *
>
> But when, as here, the corporation has gone into the State to do local business by state permission and has submitted itself to the taxing power of the State, it can avoid taxation on some Illinois sales only by showing that particular transactions are dissociated from the local business and interstate in nature.

340 U.S. at 537.

Thus, the guiding principles applicable here are clear, practical and fair. Under *Complete Auto* a transaction may not be taxed unless it has a substantial nexus with the taxing jurisdiction. And even where the taxpayer is engaged in local business in the taxing jurisdiction, under *Norton* that local business does not serve to create a substantial nexus if the sales in question are dissociated from the taxpayer's local business. Accordingly, in the present case Armco's West Virginia coal mines and South Charleston office afford no constitutional justification for taxing the sales at issue here.

2. *COMPLETE AUTO* REAFFIRMED THE TRADITIONAL NEXUS RULES UNDERLYING *NORTON*.

The West Virginia tax at issue here is denominated a "privilege" tax. J.S. 58a. Assuming the impotence of *Norton*, Appellee goes on to interpret *Complete Auto* as approving all state taxes on the "privilege" of carrying on any activity which might be said to enjoy benefits provided by the state.

> The nexus requirement of the Commerce Clause is virtually identical to that of the Due Process Clause. Both constitutional provisions require a minimal local activity, which is afforded by the state benefits and services. If such local activity is present, a tax may be imposed in return for the benefits and protections the state provides.

Appellee's Br. 44.

It is true that *Complete Auto* rejected the rule "that a state tax on the 'privilege of doing business' is *per se* unconstitutional when it is applied to interstate commerce." 430 U.S. at 289. But in doing so, this Court certainly did not hold that every tax on the privilege of doing any business within a state was *per se* valid. The *Complete Auto* decision simply neutralized the effect of a state's use of the privilege terminology:

> There is no economic consequence that follows necessarily from the use of the particular words, "privilege of doing business," and a focus on that formalism merely obscures the question whether the tax produces a forbidden effect.

430 U.S. at 288.

Having rejected the significance of the language used by the state legislature in imposing the tax, *Complete Auto* made no substantive change in the constitutional limitations on a state's jurisdiction to tax. It did, however, require a more realistic analysis of the practical effect of a tax, and formulated from prior decisions of this Court the now familiar four-prong interpretation of the Commerce Clause:

> These decisions have considered not the formal language of the tax statute but rather its practical effect, and

> have sustained a tax against Commerce Clause challenge when the tax is applied to an activity with a substantial nexus with the taxing State, is fairly apportioned, does not discriminate against interstate commerce, and is fairly related to the services provided by the State.

430 U.S. at 279. *See also Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 615 (1981).

Returning to the West Virginia tax on the gross receipts from wholesale sales, under *Complete Auto* the question here remains whether the Armco sales at issue constitute "an activity with a substantial nexus" with West Virginia.

B. MERE SOLICITATION IS INSUFFICIENT TO JUSTIFY TAXATION OF GROSS RECEIPTS FROM ARMCO'S SALES TO WEST VIRGINIA CUSTOMERS.

Appellee urges this Court to conclude that the solicitation within West Virginia of some of the sales in question here is sufficient to establish the required substantial nexus with West Virginia.[2] Appellee's proposal to tax the proceeds of sales which were merely solicited in West Virginia, as *amicus* Washington State observes, "invites the Court to plow new ground." *Amicus* Br. 5. For the reasons noted below, it is not necessary for this Court to adopt new rules regarding the sufficiency of mere solicitation to establish a nexus for imposition of gross receipts taxes, and Appellee's invitation to do so should be declined.

Continuous Local Presence. Appellee relies heavily upon *Standard Pressed Steel Co. v. Washington Dep't of Revenue*,

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2 As noted above, the Circuit Court found that there was no solicitation in West Virginia of Armco's sales of metal buildings, and that, of the remaining sales at issue, some 77 percent were solicited outside West Virginia. Armco pointed out in its Brief on the Merits that the 77 percent figure was apparently taken from a reference by a witness to the year 1976, a year outside the audit period involved. Armco Br. 5 n.2; *see* J.A. 17. However, from the context of the testimony the Circuit Court was wholly justified in its factual findings with respect to solicitation in West Virginia. Moreover, neither the decision of the Court below nor the Appellee's Brief on the Merits evidences any disagreement with the Circuit Court's conclusions.

419 U.S. 560 (1975), suggesting that the taxpayer's resident full-time employee in *Standard Pressed Steel* should be deemed equivalent to the nonresident Armco salesmen who solicited orders from time to time within West Virginia. Appellee's Br. 45-50.[3] In *Standard Pressed Steel*, the taxpayer employed an engineer whose function was to maintain continuous contact with the taxpayer's sole customer in the State of Washington. That engineer operated out of his home and could be reached through a local answering service maintained by the taxpayer. Upon these facts, this Court determined that there existed between the taxpayer and Washington State a sufficient nexus to support the imposition of tax by Washington State on sales to the taxpayer's local customer. That determination was based upon the employee's continuous availability to and constant interaction with the customer. Thus, in *Standard Pressed Steel* there was a continuous presence of the taxpayer within the state so that on a daily basis it held itself out as doing business there and could be found locally at any time by its customer. That situation is in marked contrast to the frequency and nature of Armco's solicitation activities in West Virginia, which fall far short of constituting a continuous local presence in West Virginia and do not involve the constant availability of Armco personnel to customers in West Virginia. That shortfall precludes Armco's solicitation activities from establishing a nexus between West Virginia and Armco's sales to West Virginia customers sufficient to support imposition of the West Virginia business and occupation tax.

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3 *Amicus* Washington State, on the other hand, concedes that prior decisions of this Court "support the conclusion" that a distinction is to be drawn between the continuous presence of a taxpayer within a state by the maintenance of a local sales office or employment of resident sales personnel, and the mere occasional presence through sporadic use of nonresident solicitors. *Amicus* Br. 10-11. *Amicus* Washington State, however, invites this Court "to re-examine the questions of the constitutional necessity of using an in-state office or resident personnel." *Amicus* Br. 11. Armco agrees that the distinction described by *amicus* Washington State distinguishes this appeal from *Standard Pressed Steel*, but suggests that this distinction is both reasonable and necessary.

Obligation to Withhold Sales or Use Taxes. Appellee's analysis of the decisions of this Court blurs the distinction between the simple nexus sufficient to enable a state to require a seller to withhold sales or use taxes and that necessary to impose a tax on the seller. That analysis would lead one to conclude that any access to the potential market, consisting of a state's inhabitants or their purchasing power, is sufficient constitutional justification for state taxation. That conclusion, however, is drawn from cases involving sales and use taxes imposed by a state on its local inhabitants for the acquisition or consumption of property within the state. In this area a fairly minimal presence of the seller within the state serves to validate the imposition on it of an administrative obligation to act as collector by withholding the sales or use tax imposed upon the local purchaser or user. *See National Geographic Soc'y v. California Bd. of Equalization*, 430 U.S. 551 (1977); *Scripto, Inc. v. Carson*, 362 U.S. 207 (1960). However, recognizing mere access to the state market as adequate for levying gross receipts taxes directly against the seller would be quite a different matter. To do so would sanction what would amount to a state import duty, and so would frustrate the very purposes of the Commerce Clause: to create an area of free trade among the several States (*Commonwealth Edison*, 453 U.S. at 618), and to prohibit the multiplication of preferential trade areas destructive of the free commerce anticipated by the Constitution (*Maryland v. Louisiana*, 451 U.S. 725, 754 (1981)).

Federal Legislation. In the area of apportioned state net income taxes Congress has provided that mere solicitation does not provide a sufficient nexus for state taxation. Interstate Income Tax Act, 15 U.S.C. §§ 381 *et seq.*[4] Nevertheless, Appellee urges that an out-of-state seller, exempted by federal

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4 That legislation arose in reaction to the decision of this Court in *Northwestern States Portland Cement Co. v. Minnesota*, 358 U.S. 450 (1959), where a state tax was upheld because the taxpayers each maintained a small sales office in the taxing state. The opinion in *Northwestern States*, however, acknowledged that "a State 'cannot impose taxes upon persons passing through the state, or coming into it merely for a temporary purpose' such as itinerant drummers." 358 U.S. at 458 (quoting *Robbins v. Taxing District*, 120 U.S. 489, 493-94 (1887)).

legislation from apportioned net income taxes, should be subject to gross receipts taxes based solely upon solicitation within the taxing state. Consider, however, the consequences of adopting that view. If Armco's only activity in West Virginia were solicitation of orders, West Virginia could not under federal law impose a net income tax upon Armco even if it had scores of salesmen continuously soliciting orders in West Virginia and made substantial profits from the resulting sales. On the other hand, under Appellee's constitutional theory, the handful of part-time nonresident salesmen involved here would be sufficient to support a gross receipts tax even if the solicited sales resulted in a net loss. Such an incongruous pattern of taxation would be completely illogical.[5] And while we recognize that legislation cannot be thought to affect the meaning of the Constitution, we submit that the statutory limitation upon state taxation of net income lends support to the conclusion that the traditional requirement of substantial nexus between the transactions taxed and the taxing jurisdiction should not now be relaxed with respect to gross receipts taxes.

Practical Effect of the West Virginia Tax. In line with this Court's admonition to focus on the practical effect of a challenged tax, it is important to consider the revenue producing activities which generated the gross receipts which West Virginia seeks to tax. Within West Virginia one finds only occasional solicitation by nonresidents of some West Virginia customers. Wholly outside West Virginia, however, the orders are received and accepted, raw materials are assembled, and the product itself is manufactured and delivered to a common carrier. Against this background, and claiming that Armco is resisting payment of a "fair share" of West Virginia taxes, the state steps far beyond its boundaries. Pointing only to a very few part-time nonresident salesmen, a constitutional right is

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5 This conclusion is underscored by this Court's observation that a gross receipts tax is "inherently more burdensome" than an apportioned net income tax because the gross receipts tax is applicable "whether or not the interstate concern is profitable and its imposition may make the difference between profit and loss." *Moorman Mfg. Co. v. Bair*, 437 U.S. 267, 281 (1978).

asserted by West Virginia to tax the entire gross receipts resulting from activities carried on by Armco almost entirely without the state. That assertion simply makes no economic sense. And more important, it violates well established constitutional standards. *See Western Live Stock v. Bureau of Revenue*, 303 U.S. 250 (1938); *Gwin, White & Prince, Inc. v. Henneford*, 305 U.S. 434 (1939); *McLeod v. Dilworth Co.*, 322 U.S. 327 (1944). One looks here in vain for any "rational relationship between the sales income attributed to the State and the intrastate values of the enterprise" as required by the Due Process Clause. *Mobil Oil Corp. v. Comm'r of Taxes*, 445 U.S. 425, 436-37 (1980). In short, the practical effect of the tax sought here to be applied to Armco's sales is extraterritorial taxation.

II

DISCRIMINATION AGAINST INTERSTATE COMMERCE

Armco adheres to the view that the West Virginia business and occupation tax under review is discriminatory on its face and contains an intrinsic discriminatory defect.

A. THE TAX IS DISCRIMINATORY ON ITS FACE.

The West Virginia gross receipts tax involved here applies to wholesale sales by manufacturers to West Virginia customers of property manufactured outside the state. It does not apply to identical sales of property manufactured in West Virginia. The situation is just that simple. Legal niceties to one side, on the face of it the local exemption from tax is so clearly discriminatory against interstate commerce that it brings to mind Mr. Justice Stewart's observation that "I know it when I see it." *Jacobellis v. Ohio*, 378 U.S. 184, 197 (1964).

The constitutionally saving grace, according to Appellee and *amicus* Washington State, stems from the fact that West Virginia imposes a gross receipts tax upon its local manufacturers which, obviously, is not imposed on manufacturers operating outside the state. In a broad sense, the argument is that this evens up the interstate score. More specifically, the thought is that because Armco does not have to pay the tax on

manufacturing in West Virginia, it is constitutionally permissible to exempt local manufacturers from the tax on wholesale sales which is imposed upon Armco.[6] In fact, *amicus* Washington State expressly concedes that, but for the alleged requirement that the effect of the taxes on wholesaling and manufacturing be examined together, "an unconstitutional discrimination would unquestionably exist." *Amicus* Br. 16.

Before turning to an analysis of the authorities in this area, we note that taxes are a fact of life in each of the states, and that each of them imposes various types of taxes on manufacturing operations within its borders. Thus, it is not at all surprising that manufacturers in West Virginia are subjected to a tax for which Armco is not liable. It also seems safe to conclude that Armco is subject to taxes outside West Virginia which are not imposed upon West Virginia manufacturers. Far less than clear, however, is what relevance other taxes, whether within or without West Virginia, have in resolving the issue of whether the West Virginia tax on wholesale sales is itself discriminatory.

There are two theories which, if applicable, might make the West Virginia tax on manufacturing relevant to a consideration of the constitutionality of the West Virginia tax on wholesale sales. First, it might be asserted that the tax on wholesale sales complements the manufacturing tax in the same manner that a state use tax complements a sales tax. *See, e.g., Boston Stock Exchange v. State Tax Comm'n*, 429 U.S. 318, 331-32 (1977); *Henneford v. Silas Mason Co.*, 300 U.S. 577, 583-84 (1937); *Gregg Dyeing Co. v. Query*, 286 U.S. 472 (1932). Or second, it might be asserted that a portion of the tax on manufacturing is imposed in respect of an anticipated eventual wholesale sale by the manufacturer of his product and, as a result, in-state manufacturers pay tax on their wholesale sales under the guise of the manufacturing tax provision. For the reasons noted below, neither of these two arguments can be supported here.

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6 Appellee agrees that *Columbia Steel Co. v. State*, 30 Wash. 2d 658, 192 P.2d 976 (1948), invalidated an identical scheme to the one under consideration in this appeal as unconstitutionally discriminatory against interstate commerce. Appellee's Br. 85. Appellee concludes, however, that *Columbia Steel* is, in the words of *amicus* Washington State, "simply wrong." *Amicus* Br. 17 n.12.

1. THE WEST VIRGINIA TAX ON WHOLESALE SALES DOES NOT COMPLEMENT THE TAX ON MANUFACTURING.

Appellee and *amicus* Washington State cite a number of cases involving compensatory taxes where this Court has held that a tax which applied to interstate commerce, but not to intrastate commerce, did not discriminate against interstate commerce because (i) intrastate commerce was subject to a second tax that did not apply to interstate commerce, and (ii) the tax on interstate commerce was intended to complement the local tax. *E.g.*, *Alaska v. Arctic Maid*, 366 U.S. 199 (1961); *Gregg Dyeing Co. v. Query*, 286 U.S. 472 (1932); *Hinson v. Lott*, 75 U.S. (8 Wall.) 148 (1869). These cases are offered as authority for the proposition that because Armco is not subject to the West Virginia tax on manufacturing, the state may properly excuse local manufacturers from the tax on wholesale sales which the state exacts from Armco. That analysis fails, however, because the tax on wholesale sales cannot act to compensate for the effect of the West Virginia manufacturing tax on in-state manufacturers.

Precisely this question was considered in *Maryland v. Louisiana*, 451 U.S. 725 (1981). In that case, Louisiana imposed a use tax (the "First-Use Tax") with respect to gas produced in the federal Outer Continental Shelf ("OCS") and then piped to processing plants in Louisiana. This Court held that the tax violated the Commerce Clause because the effect of various credits and exclusions was to cause the tax to apply to gas sold in interstate commerce but not to gas sold in intrastate commerce. The State of Louisiana argued that gas produced in Louisiana was subject to a severance tax which was not imposed upon gas extracted from the OCS, and that this justified the otherwise discriminatory nature of the First-Use Tax. This Court flatly rejected that argument, pointing out that Louisiana could not impose a severance tax on gas produced outside of Louisiana and, accordingly, a tax on such gas could not be a complement to the severance tax:

> In our view, the First-Use Tax cannot be justified as a compensatory tax. The concept of a compensatory tax

> first requires identification of the burden for which the State is attempting to compensate. Here, Louisiana claims that the First-Use Tax compensates for the effect of the State's severance tax on local production of natural gas. . . . But the First-Use Tax is not designed to meet the same ends since Louisiana has no sovereign interest in being compensated for the severance of resources from the federally owned OCS land. *The two events are not comparable* in the same fashion as a use tax complements a sales tax. In that case, a State is attempting to impose a tax on a *substantially equivalent event* to assure uniform treatment of goods and materials to be consumed in the State. No such equality exists in this instance.

451 U.S. at 758-59 (emphasis added).

The argument here that the tax on wholesaling complements the tax on manufacturing is exactly the same as the unsuccessful argument made by Louisiana. West Virginia is without power to tax the manufacturing activities conducted by a foreign corporation in another state, just as Louisiana was without power to impose a severance tax on gas produced on federal OCS land. Accordingly, a tax on wholesale sales of products manufactured outside West Virginia cannot be viewed as a compensatory tax intended to complement the tax on local manufacturing. Moreover, wholesaling and manufacturing are not "substantially equivalent event[s]" and, as a result, taxes on those activities cannot be viewed to be mutually compensatory. In short, justifying the taxation of Armco's wholesale sales by relying on the fact that Armco is not subject to the West Virginia tax on manufacturing is directly contrary to *Maryland v. Louisiana, supra.*

The requirement of a relationship between those taxes which may properly be viewed together for purposes of determining whether a tax is discriminatory with regard to the economic burdens it imposes was recently underscored in *Washington v. United States*, 103 S. Ct. 1344 (1983). In that case, this Court held that, although separate provisions of a single sales tax scheme should be viewed together in testing for discrimination, "[a] different situation would be presented if a State imposed a

sales tax on contractors who work for the Federal Government, and an entirely different kind of tax, such as a head tax or a payroll tax, on every other business." *Id.* at 1350 n.11. The West Virginia tax on wholesale sales, when compared to the tax on manufacturing, is "an entirely different kind of tax," and it is improper to combine them for purposes of analyzing the discrimination issue.

The compensatory tax cases cited by either Appellee or *amicus* Washington State, *Alaska v. Arctic Maid*, *supra*, *Gregg Dyeing Co. v. Query*, *supra*, and *Hinson v. Lott*, *supra*, may each be distinguished from this appeal under the guidelines of *Maryland v. Louisiana*, *supra*, and *Washington v. United States* because they each involved taxes imposed on comparable, substantially equivalent events.[7]

In *Arctic Maid*, Alaska imposed a four-percent tax on the value of fish taken from Alaskan waters by freezer ships which would transport the fish to the State of Washington for canning. Under another provision of the Alaskan statutes, local canneries (which did not use freezer ships) paid a six-percent tax on the value of salmon obtained for canning. An objection to the four-percent tax applicable to the freezer ships was posed under the Commerce Clause on the ground that it applied only to fish in interstate commerce. This Court upheld the tax, finding that the tax paid by freezer ships complemented the higher tax paid on fish acquired by the Alaskan canneries. The incident of taxation was the same for both in-state and out-of-state processors—the acquiring of the fish to be canned. *Arctic Maid* is entirely consistent with Armco's

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7 Another case cited by Appellee, *Caskey Baking Co. v. Virginia*, 313 U.S. 117 (1941), did not involve a compensatory tax, but is also distinguishable from this appeal. An out-of-state baker which peddled bread in Virginia was required to pay a Virginia license tax of $100 on each vehicle used in the business of peddling. In response to the Commerce Clause challenge to the tax posed by the baker, this Court simply held that because all peddlers, whether resident or not, were subject to the same license tax, there was no violation of the Commerce Clause. In addressing the Commerce Clause issue, no consideration was given to other state taxes on local businesses; rather, those taxes were referenced only in the Court's Equal Protection Clause discussion, which is not relevant to this appeal.

view that the effect of various taxes should be compared only when imposed on "substantially equivalent event[s]."

Gregg Dyeing Co., supra, involved a compensating use tax of the type specifically distinguished in *Maryland v. Louisiana, supra*. And in *Hinson, supra*, Alabama imposed a direct tax of 50 cents per gallon on "spirituous liquors." Under one section of the statute, the tax was paid by in-state manufacturers, and under another section it was paid by dealers on liquor brought into Alabama from other states. This Court held that the tax on imported liquor "was only the complementary provision necessary to make the tax equal on all liquors sold in the State." *Id.* at 153. Thus, those tax provisions were of the type approved in *Maryland v. Louisiana, supra*, and distinguished by that case from taxes imposed upon unrelated events. Because *Hinson* involved a direct tax on property, rather than taxes imposed on specific activities, the complementary provisions clearly shared identical objects of taxation. That case offers no guidance to this appeal, where the objects of the tax are separate and distinct activities and are not substantially equivalent.[8]

2. NO PORTION OF THE TAX ON MANUFACTURING IS IN FACT IMPOSED UPON WHOLESALE SALES.

If some portion of the tax on local manufacturing in West Virginia actually constituted a tax on the sale (rather than the production) of local products, Armco's discrimination argument would be blunted because local manufacturers could then be said to be paying a tax on their wholesale selling activities. However, the tax on manufacturing is simply not in part a tax on wholesale sales. One might as well point to local property taxes in West Virginia to cure the discrimination in the wholesale sales tax.

As a matter of statutory construction, the West Virginia statute itself illustrates clearly that the manufacturers tax is not in lieu of the wholesale sales tax. It is precisely what it says it

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8 *See Walling v. Michigan*, 116 U.S. 446 (1886), confirming that taxes imposed on activities which are not substantially equivalent cannot be mutually compensating.

is—a tax on manufacturing. This is confirmed by the fact that the manufacturing tax must be paid even where there is no local wholesale sale of the manufactured product. For example, the tax on manufacturers applies *in full* to the manufacture of products which are not sold (*e.g.*, where the product is consumed by the manufacturer). In addition, the tax applies *in full* to the manufacture of products sold outside the state (which sales are beyond the state's taxing reach). And finally, local manufacturers must pay the tax on retailing when making sales at retail, notwithstanding the requirement that the tax on manufacturing must also be paid *in full* in respect of the product sold. *See* Appellant's Br. 23-24. If there were any merit to the assertion that the tax on manufacturing should be viewed in part as a tax on wholesale sales, the manufacturing tax would have to be reduced where the product is not sold at wholesale within West Virginia. There is no such reduction.

The shortcoming of all of the arguments advanced to support Appellee's position is that they never come to grips with the fact that the tax on wholesale sales is imposed on a wholly different activity from the tax on manufacturing. That fundamental difference precludes the former tax from complementing the latter and precludes the conclusion that in part the tax on manufacturers is imposed with respect to wholesale sales.

B. THE TAX CONTAINS AN INTRINSIC DISCRIMINATORY DEFECT.

Appellee's brief offers no response to Armco's argument that the exemption of local manufacturers from the tax on wholesale sales causes the West Virginia tax system to be intrinsically discriminatory against interstate commerce. *Amicus* Washington State takes up this argument, but concludes that it is essentially the same as a multiple taxation theory and discusses it in that context. There is, however, a basic distinction between a multiple taxation problem and the argument Armco makes here.

A multiple taxation theory proceeds from the argument that more than one jurisdiction is taxing the same activity or event. The complaint engendered in such cases is that two states exact

(in respect of a single activity or event) an aggregate tax which is constitutionally burdensome. Armco does not contend here that it is subject to impermissible multiple taxation. Rather, it does claim that the West Virginia scheme of taxation contains an intrinsic defect which causes it to favor intrastate commerce.

If, as the Appellee asserts, the West Virginia tax on wholesale sales were not discriminatory, then clearly other states would be free to adopt an identical system of taxation. Analysis of what would happen, however, if even one other state were to adopt the West Virginia scheme of taxation confirms that the West Virginia tax contains an intrinsic defect that makes it necessarily discriminatory. That defect can be illustrated by hypothesizing the existence of a second state with a tax system identical to that of West Virginia. The result would be that all wholesale sales in one of the states by manufacturers operating in the other state would result in a greater total tax than similar transactions involving only one of the states. This result, however, does not stem from multiple taxation by the two states. Indeed, one state would tax manufacturing and the other wholesale selling—a situation which establishes no claim of multiple taxation. Rather, the discrimination demonstrated is the consequence of the favoritism shown to intrastate commerce by forgiving the tax on wholesale sales if (and only if) manufacture and sale both take place in the same state.

The distinction between the intrinsic defect Armco identifies here and a multiple taxation problem is that the latter, as pointed out by *amicus* Washington State, is ordinarily the product of interaction between two *differing* tax statutes, and culpability often cannot be attributed to one or the other system.[9] Where the statutes of both states are identical, how-

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9 For that reason, and because it is often easy to hypothesize a second tax system (unrelated in operation to one being reviewed) which would result in multiple taxation in conjunction with a system under review, this Court has declined to examine multiple taxation questions in the absence of a demonstration of multiple taxation in fact. *See Standard Pressed Steel, supra*; *General Motors Corp. v. Washington*, 377 U.S. 436 (1964). Those difficulties are not presented, however, where the hypothetical second system is identical to the one under review.

ever, the defect is clearly intrinsic to the single system that has been duplicated, and that defect causes the system to fail the standard of "internal consistency" articulated in *Container Corp. of America v. Franchise Tax Bd.*, 103 S. Ct. 2933, 2942 (1983).

It should be noted that the defect complained of by Armco arises out of the wholly intrastate operation of the West Virginia tax—that is, out of the local manufacturer exemption from the tax on wholesale sales. Consequently, although hypothesizing an identical tax system in a second state makes it easier to illustrate the discriminatory effect of the West Virginia scheme, such a second system is not required to produce the discrimination protested by Armco. The internal consistency standard requires reference to a hypothetical second state tax system merely to test for the discriminatory characteristic; failure to meet that standard, however, does not in any way depend upon the existence of an identical scheme in another state.

Thus, the objection of *amicus* Washington State that Armco's argument is merely hypothetical is not well taken. The concerns that have caused this Court to require a showing of actual multiple taxation are not present where the defect complained of does not involve multiple taxation and is intrinsic to the system under review. Moreover, because the favoritism toward intrastate commerce identified by Armco is intrinsic to the West Virginia scheme and results from wholly intrastate transactions, the harmful discrimination against Armco's interstate commerce with West Virginia obtains without regard to whether there actually exists a second state which imposes identical taxes.

CONCLUSION

Constitutional limitations on the power of the states to tax multistate businesses have consumed a significant amount of this Court's time in recent years. The result, however, has been that in the area of net income taxes we have arrived at workable rules which achieve at least rough justice in the large majority of cases. Although controversy still surrounds foreign

aspects of the unitary business theory, on the domestic level the theory works well in segregating the total net income to be taxed. And apportionment formulas, although not entirely uniform, in general work well in apportioning total net income among the various states. No such constitutional progress, however, has been made in the area of gross receipts taxes.

This case presents this Court with an opportunity to define fair and practical constitutional guidelines governing gross receipts taxation. Armco urges the Court to seize that opportunity. Further, Armco submits that the unitary business theory should be found to have no application to gross receipts taxes. The rule dictated by precedent, and by an equal regard for the financial needs of states and taxpayers alike, is that a transaction subject to gross receipts taxation must arise in the context of a substantial permanent presence within the taxing jurisdiction. Mere solicitation should be declared insufficient, and the decision of the Court below should accordingly be reversed.

Alternatively, if this Court finds that sufficient nexus exists here to justify the gross receipts taxes at issue, the decision of the Court below should nonetheless be reversed because the West Virginia tax on the gross receipts from wholesale sales discriminates against interstate commerce in violation of the Commerce Clause.

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